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Russo, R.

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Edited by

Dennis Weber

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Chapter 5

CCCTB: General Principles and Characteristics

Ronald Russo

1. INTRODUCTION

The Proposal for a Council Directive on a Common Consolidated Tax Base of 16 March 2011 (the Proposal) effectively contains a European Corporate Tax system and a European Tax Base. Although I do not agree with some of the choices that were made in drafting the Proposal, I congratulate the CCCTB Working Group with the result. They clearly have invested an enormous amount of (thinking) work in this Proposal. In this chapter, I will focus on the general principles and characteristics of the Tax Base part of the proposal.

The Proposal lists some 'General Principles' as such (for instance, Articles 9 and 17), but a number of characteristics is not specifically mentioned. In this chapter I will give attention to both categories. After that I will look more closely into a number of concrete possible problem issues.

2. GENERAL CHARACTERISTICS

Looking at the Proposal, specifically at the articles concerning the Tax Base (Chapters 4, 5 and 6), a few general characteristics can be discerned:

– The Proposal is based on a profit and loss account approach.

Dennis Weber (ed.), *CCCTB: Selected Issues*, pp. 67–77.

- As mentioned in the introduction the Proposal contains both rules concerning the Tax Base as well as (basic) rules for a Corporate Income Tax.
- The relationship between the Directive itself and the Delegated Acts: main rules in the Directive, details in Delegated Acts.
- The Proposal has an independent concept of profit.
- There is no fall back system for issues not regulated in the Proposal.

3. PROFIT AND LOSS ACCOUNT APPROACH

In the Proposal the calculation of the Tax Base has taken the form of a profit and loss account (P&L) approach (Article 10) as opposed to a balance sheet approach. This is in a sense not a fundamental choice, the P&L approach can also lead to a balance sheet. If, for instance, the depreciation cost are calculated for the P&L approach, this must also lead (somewhere) to a tax book value of the assets. There might however be possible problems with this approach as was mentioned during the ACTL seminar of June 10 and 11 in Amsterdam. For instance, whether the waiver of a loan should constitute income for the debtor is solved automatically in a balance sheet approach, but needs a separate rule (stating such a waiver is income) in a P&L approach.

A P&L approach seems to be the more obvious approach[1] for a jurisdiction in which the calculation of the profit for tax purposes is linked to the commercial accounts of the company.[2] In this Proposal however the choice was made for an independent concept of profit, therefore, the choice for a P&L approach is not obvious.

4. TAX BASE AND CORPORATE INCOME TAX

In many European Member States the Tax Base and Corporate Income Tax are situated in different laws. This is most obvious in Member States where the calculation of the Tax Base is linked to the commercial accounts. In the Netherlands, there is no such formal link, but still the Tax Base is not situated in the Corporate Income Tax Act. The choice to incorporate both matters in the Proposal has made it both voluminous as well as difficult to split. If there is no (political) possibility for a complete Common Consolidated Corporate Tax Base (CCCTB), there might still be room for a Common Corporate Tax Base. In that case, the proposal would have to be split up.

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1. See The determination of Corporate Taxable Income in the EU Member States edited by Endress, Oestreicher, Scheffler, Spengel, Kluwer Law International, 2007, p. 25.
2. For more information on ‘linking’ see P. Essers and R. Russo, The influence of IAS/IFRS on the CCCTB, Tax Accounting, Disclosure, and Corporate Law Accounting Concepts, p. 31–37.

> However, the challenge (for the CCCTB Working Group) is to go for a CCCTB and not to prepare for a CCTB as a second best. I understand the choice for an all encompassing proposal, but I also wonder if more flexibility (two separate proposals) would have been prudent. It certainly would have been more in line with current Tax Law Practice in most Member States.

5. RELATIONSHIP BETWEEN DELEGATED ACTS AND THE DIRECTIVE

It is difficult to get unanimous approval of all Member States so that a draft proposal may become a Directive. The Commission is faced with the dilemma of what to regulate in the Directive itself (the main issues) and what to leave to the Delegated Acts. Through Delegated Acts the Commission can act more swiftly and decisively to settle more detailed issues, mainly because unanimity is not required in the decision process. In the 'whereas clauses', nr 24, the Commission asks to be empowered to adopt Delegated Acts for an indeterminate time.

The scope of the Delegated Acts (for the Tax Base) is limited to what is mentioned in aforementioned nr 24: list of non-deductible taxes, rules on definition of legal and economic ownership in relation to leased assets, the calculation of the capital and interest elements of leasing payments and the depreciation base of a leased asset.

The rules in the Delegated Acts are mainly concerned with leasing and, therefore, will have a limited impact. For leasing the Delegated Acts will probably act as safe have rules so parties involved in a leasing agreement will be able to determine simply who may depreciate the asset involved.

Other issues can apparently not be covered by Delegated Acts, which is probably a lost opportunity for the Commission to control the development of the content of the Directive. Strange in this respect is Article 42 on the basis of which the Commission may adopt Delegated Acts on defining categories of fixed assets as this is not mentioned in the aforementioned nr 24.

I will come back to the issue of Delegated Acts in sections 6 and 7.

6. INDEPENDENT CONCEPT OF PROFIT/NO FALL BACK SYSTEM

In drafting the Proposal the CCCTB Working Group was presented with the problem how to regulate the calculation of profit for the CCCTB. Apparently it was not an option to link the Tax Base to the commercial profit. Although the commercial profit has to some extent been harmonised within the EU, this was not an easy process. At this moment listed companies must present their consolidated commercial accounts on the basis of the International Financial Reporting Standards (IFRS). There is no such obligation for the single accounts, a major reason being that many Member States use the single accounts as a starting point for the tax accounts. Member States clearly had resistance to the IASB in some way (co) determining the tax base.

This resistance has had its influence on the Proposal (and its predecessors). The IFRS were first a starting point, but later in the process of forming the Proposal they were not mentioned at all. In the actual articles of the Proposal and its predecessors IFRS could and can be seen clearly. As Thomas Neale stated in his paper,[3] IFRS was the common language for the members of the CCCTB WG and so materially has found its way in the Proposal, although formally there is no relationship.

So there is no formal link between the CCCTB concept of profit and the commercial accounts, IFRS or (any) national GAAP. The CCCTB profit is an independent concept and as such new and unique. The problem is then how to give this new concept the substance it needs so it can be used in practice by tax payers and tax authorities (and Courts if these parties disagree).

In general, two methods exist to create substance for a concept of profit:

– list some principles and leave the creation of substance to case law and/or standards (drafted by representatives of stakeholders and subject to case law);
– section incorporate a detailed set of rules in the legislation.

In the Proposal the choice is mixed: there are a few general principles and many concrete rules (but not detailed enough to solve all issues, see section 6.2). The substance of the CCCTB profit can further be created by case law (for the issues not or insufficiently regulated), but this might present difficulties. Disagreements between tax payers and tax authorities must be judged primarily by the Courts in the Member State of the principal tax payer. It will be difficult to keep track of the decisions of these Courts in 27 Member States and even more difficult to integrate them into a workable system, especially as I expect there will be (many) contradictory verdicts. The Proposal does not provide for a back up system for issues not regulated, so each Court will view the CCCTB within its own domestic background and these backgrounds will influence their decisions.

I will view the general principles and some of the concrete rules in the Proposal separately.

6.1. General Principles

The general principles of the Tax Base mentioned in the proposal are:

(a) Profits and losses shall be recognised only when realised (Articles 9).
(b) Transactions and taxable events shall be measured individually (Article 9).

3. Thomas Neale in: CCCTB: how far have we got and what are the next steps, s. 2.1, Common Consolidated Tax Base (Lang, Pistone, Schuch, Staringer), Series on international tax law 53, Linde Verlag Wien, 2008.

(c) The calculation of the tax base must be consistent unless exceptional circumstances justify a change (Article 9).
(d) The tax base shall be determined for each tax year, unless otherwise provided and be any 12-month period unless otherwise provided (Article 9).
(e) Revenues, expenses and deductible items shall be recognised in the tax year in which they accrue or are incurred, unless otherwise provided (Articles 17, 18, 19).
(f) Related parties and shareholders must be dealt with on an at arms' length basis (Articles 15 and 79).

General principles that I miss are the principles of continuity, prudence, simplicity and substance over form. The continuity principle presupposes that the company will continue its business (going concern, see the IASB Framework, section 23). For instance, in valuation matters usually not the liquidation value, but the going concern value must be applied. As I do not think that the CCCTB WG does not agree with this principle, the reason for this omission is not clear to me.

The prudence principle[4] is known in many tax jurisdictions and commercial accounting (see the IASB Framework, section 37), but as such not mentioned in the Proposal. A number of rules based on this principle have however been incorporated in the Proposal (for instance, Article 25 (provisions), Article 27 (bad debt deductions), Article 29, section 4 (stock valuation at the lower of cost and net realisable value) Article 41 (exceptional depreciation). Apparently the CCCTB WG in this particular case has chosen a rule based approach in stead of a principle based approach.

On the basis of the simplicity principle companies are in some cases allowed to deviate from the rigid demands of accrual and realisation. As the size and complexity of the company play an important role in the application of this principle and CCCTB is primarily meant for international companies, I understand that the CCCTB WG has chosen not to incorporate this principle. In some cases however the simplicity principle can be called upon by Tax Authorities.[5] Apparently for CCCTB this is not the intention. Substance over form, like the others, is also to be found in the IASB Framework (section 35) and many tax systems.[6] The reason not to incorporate this principle is perhaps that potentially is could be interpreted very widely (by tax authorities) and so would make the CCCTB unattractive for companies.

Most of the other general principles listed are to be expected in any Tax Base (B, D, F). Still the CCCTB WG has made some choices where other choices were possible or perhaps desirable.

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4. See The determination of Corporate Taxable Income in the EU Member States edited by Endress, Oestreicher, Scheffler, Spengel, Kluwer Law International, 2007, p. 27.
5. For an example see HR 28 January 2011, BNB 2011/85.
6. See The determination of Corporate Taxable Income in the EU Member States edited by Endress, Oestreicher, Scheffler, Spengel, Kluwer Law International, 2007, p. 29.

Under A it is stated that profits and losses shall be recognised only when realised. Clearly this is a compromise as many Member States allow losses to be recognised when they occur without having to be realised.[7] In some specific cases it is possible to recognise a loss without realisation, but in the system of the Proposal a specific article is required (for instance Article 29, section 4). It will be interesting to see how Courts those have to decide issues not foreseen in the Proposal will react, especially if their domestic tax law rules are more flexible on this point.

Under C it is stated that the calculation of the Tax Base must be consistent unless exceptional circumstances justify a change. Again it will be interesting to see how Courts will apply this rule. In the domestic tax law rules of the Netherlands, a similar rule applies. The Supreme Court (HR 14 June 1978, BNB 1979/181) has ruled that a system may be changed at any time as long as the main reason for the change is not to obtain an incidental tax advantage. To obtain a structural tax advantage is permitted. It is not unlikely that the Supreme Court would rule the same for the CCCTB. I wonder if the CCCTB WG had this in mind when they drafted the Proposal.

Under E the accrual principle is listed and in itself this is no surprise. Most systems of calculating commercial and tax profit are based on this principle (see the IASB Framework, section 22). Usually however expenses and deductible items are also ruled by this principle. If. for instance a company would rent a building for two years and would pay the rent (for these two years) at the start of the renting period, the cost would have to be spread over the two relevant years, not just the year of payment. I do not think the CCCTB WG had anything else in mind, but the use of the term ‘incurred’ for cost (and the explanation of this term in Article 19) can create uncertainty on this issue.

6.2. Concrete Rules

As mentioned under 6.1, the Proposal contains many concrete rules, but they do not cover all eventualities. Although I believe it is theoretically impossible to capture all (future) possibilities in detailed rules, the Proposal already shows issues not covered, as I will try to demonstrate in this section. I will focus on some possible problem areas but this is by no means a complete list.

6.2.1. Roll Over Relief (Article 38)

In general, depreciation in the Proposal is regulated through a pooling system, except for individually depreciable assets (Article 36: buildings, other long life tangible assets, intangible assets). If an individually depreciable asset is disposed

7. On the basis of the prudence principle, see The determination of Corporate Taxable Income in the EU Member States, edited by Endress, Oestreicher, Scheffler, Spengel, Kluwer Law International, 2007, p. 27/28.

of and the proceeds exceed the tax book value, this profit is liable to taxation. There is one exception: if the proceeds are re-invested in an asset used for the same or a similar purpose, the profit may be ‘rolled over’ to the replacement asset. The book value of the replacement asset must be reduced by the profit that was ‘rolled over’. In this way the profit is taxed ultimately because there is less depreciation on the replacement asset.

In the Netherlands there is a similar system and there is a vast amount of case law to fill in the details that cannot be found in the relevant tax law article. Article 38 of the Proposal also does not contain many of these details so case law is to be expected. Some issues that can lead to many a dispute between companies and tax authorities are:

- What is a similar purpose? Can a building that is rented out be replaced by any other rented building or must the buildings have more similarities (for instance: must they both be in the same field of business or is it possible to replace an apartment block by an industrial hall). The Supreme Court in the Netherlands has ruled that practically any rented out building may be replaced by any other rented out building (HR 10 March 2006, V-N 2006/15.17).
- What happens if the profit to be ‘rolled over’ exceeds the tax book value of the replacement asset? Is it possible to create an asset with a tax book value of nil or even a negative book value? In the Netherlands this is not possible to because of the phrasing in the relevant article (Article 8 Corporate Income tax Act and Article 3.54 Personal Income Tax Act), but the Proposal is silent on this subject.
- What is the exact moment of disposal or re-investment? Is it the moment a contract has been concluded or the moment of transfer of legal ownership (these moments can differ substantially in the case of buildings). These moments become relevant in determining whether the two year term in Article 38 has either started or terminated. In the Netherlands the contract moment is decisive, not the moment of transfer of legal ownership.
- Can re-investment take place by a group member in another Member State?
- Can re-investment take place in an asset located in another Member State or in a third country? The article does not limit re-investment to the Member State in which the profit was realised and Article 31 (transfer of assets towards a third country) does not mention roll over relief so I think it is possible.
- If the disposal of the asset gives rise to costs, do these costs reduce the amount to be ‘rolled over’? If this is the case how must companies determine which cost are to be taken into account? In the Netherlands cost must be taken into account if they are directly attributable to the disposal (HR 6 June 2008, BNB 2008/223). As there is no case law yet on what ‘directly attributable’ exactly is, more case law is expected.
- What exactly will constitute an involuntary disposal? If an asset is disposed of because this is absolutely necessary from a business point of view, a

company might view this as an involuntary disposal. The relevant tax authority might only view a calamity (for instance when a building is destroyed by fire and the insurance pay out exceeds the tax book value) as involuntary.

With the examples above, I have effectively compared some practical implications of the Netherlands system with the system of the Proposal. My point is that in cases of disputes between companies and tax authorities, the Netherlands Courts will probably tend to settle these disputes along the lines of the Netherlands national tax law, especially since this system is similar to that of the Proposal and the Proposal offers no fall back possibility. I do not know how the Courts in other Member States will rule in these cases, but I would be surprised if they would all come to the same conclusions.

6.2.2. Hedge Accounting (Article 28)

The general rule in the Proposal is (see 6.1. B) that transactions and events will be measured individually. This is a general principle of commercial and tax accounting since joint measurement in general obstructs a clear view on the relevant transactions (see IAS 1). An exception to this rule is possible: if transactions are meant to be taken into account together because fluctuation in their values shows a more or less opposite effect (jointly therefore an effect of more or less nil). This is hedge accounting or joint valuation.

Commercially, companies tend to create hedges to mitigate risks on prices, interests or currencies. For the calculation of the commercial profit they are inclined to follow the hedges. Usually this leads to the fact that a loss on a financial instrument is not taken into account because it is offset against the (possibly) unrealised gain on another asset. Commercial standards as IFRS (IAS 39 in this case) tend to allow hedge accounting if strict conditions are met.

For the calculation of the profit for tax purposes companies tend not to be too keen on hedge accounting. It often can give them the opportunity to present a loss on a financial instrument where they do not have to present the corresponding profit yet because it has not been realised yet.

In the Netherlands, the Supreme Court (HR 23 January 2004, BNB 2004/214, HR 16 November 2007, NTFR 2007/2072) has ruled that hedge accounting can be mandatory even in cases where the conditions for commercial hedge accounting are not met. Of course this is only possible in a system where there is no formal link between the commercial accounts and the tax accounts, such as the Proposal (and the Netherlands).

Article 28 seems to be a very short rendering of IAS 39 and so sets conditions that were meant for calculating the commercial profit. The main condition in this respect is that the hedging relationship must be formally designated and documented in advance. Companies might use this condition to escape having to apply hedging by, for instance, not formally designating the hedge. I do not know if the CCCTB WG intended this outcome.

6.2.3. Stock versus Material Fixed Assets

The valuation of stocks and material fixed assets is different in many ways. Usually it is not so difficult to distinguish between the two categories, but in the case of buildings it can present problems. In case law in the Netherlands, this problem focuses on the application of (the Netherlands version of) roll over relief. Roll over relief is only possible for individually depreciable assets (material fixed assets) and not for stocks. For a company that invests in buildings with the intention of selling them, the buildings effectively represent stocks, even if it takes a lot longer than usual to make the actual sale. In cases of profit on the disposal of buildings the difference between the two categories of assets becomes important if the company wishes to apply roll over relief.

In the Netherlands, there is extensive case law on this matter, in which the intention of the (board of the) company is decisive. If the intention is sale, it is stock, if not it is a material fixed asset. In the Proposal the CCCTB WG has tried to deal with this problem by inserting a minimum term of ownership in the article about roll over relief (Article 28, paragraph 1, last sentence). If an asset is disposed of voluntarily, roll over relief is only applicable if the company has owned the asset for three years. The idea is probably that this minimum period covers assets held for sale. In real estate however this does not have to be the case. Furthermore the minimum is only applicable in cases of voluntary disposal. I believe that the problem is there and will be a source of potential disagreement between companies and tax authorities.

6.2.4. Provisions

Provisions are regulated in Article 25 of the Proposal. Generally, it follows the usual requirements for a provision in commercial accounts (see IAS 37). In one obvious matter the Proposal deviates from commercial provisions: constructive obligations. A constructive obligation is an obligation that derives from actions where by an established pattern of past practice, published policies or a sufficiently specific current statement a company has indicated to other parties it will accept certain responsibilities and it has created a valid expectation on the part of those other parties that it will discharge those responsibilities (IAS 37.10). Under the proposal it is not possible to form a provision for these obligations. A legal obligation is required. This restriction to legal obligations was also present in WP 57 (the outline to the Proposal in 2007) and criticised.[8] The CCCTB WG is apparently worried that commercial rules on provisions are less conservative than tax rules should be and therefore has limited the possibility of forming provisions to cases of legal obligations. I do not believe that this worry is justified, given the fact that contingent liabilities are not recognised under IAS 37 (they only have to be disclosed but have no effect on the balance sheet). A contingent liability is a possible

8. See P. Essers and R. Russo, The influence of IAS/IFRS on the CCCTB, Tax Accounting, Disclosure, and Corporate Law Accounting Concepts, p. 71–77.

obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more future events not wholly in the control of the company (IAS 37.28).

Another reason to exclude constructive obligations is probably that it is easier for tax administrations to check the requirements for legal obligations than constructive obligations.

There is ample scope for disagreements between companies and tax authorities and therefore creation of case law to decide in specific cases whether or not the demands for a provision under the text of Article 25 of the Proposal have been met (for instance: when exactly does a legal obligation qualify, can the future event reasonably be expected to occur, when is a future benefit directly linked).

7. NO FALL BACK SYSTEM

The Proposal is based on a limited number of general principles and characteristics and contains detailed regulations on the various subjects. As I have tried to point out in this chapter the regulations leave a lot of room for interpretation. Some of the uncertainties can be remedied by regulating further in Delegated Acts, although the Proposal seems to limit the issues for which Delegated Acts are possible. The possibility of successfully using Delegated Acts will depend on how fast the Commission can agree upon and then implement them.

In this chapter I have listed several issues that are unclear and liable to discussion between companies and tax authorities. If a Court is called upon to settle such a dispute, it has only the text of the Proposal to base its decision upon. The Proposal offers no frame of reference to any set of rules or standards to give the Court some direction in the process of deciding. I assume that the Courts in each Member State will use the frame of reference they are accustomed to. As the tax systems all differ, chances are Courts in different Member States will come to very different decisions on the basis of the same facts (the European Court of Justice will eventually coordinate, but this will take a long time). I find this an undesirable effect, not only from a theoretical point of view (the law should be the same for every one), but also from a commercial point of view. Companies will be uncertain as to the extent of their tax liability and might prefer domestic tax law.

In my opinion[9] the CCCTB should provide for a fall back system for issues not regulated in the Proposal. The Courts could use this system (instead of all using their domestic system) as they settle disputes. The number of disputes will be considerably lower because companies and tax authorities will not have to go to Court on issues provided for in the fall back system. The creation of such a fall back system is not an easy matter so I suggest to make use of what is already there. Commercial Standards (such as IAS/IFRS) already exist. They could be used for the creation of CCCTB Standards. The Commission (or a council of all relevant

9. See P. Essers and R. Russo, The influence of IAS/IFRS on the CCCTB, Tax Accounting, Disclosure, and Corporate Law Accounting Concepts, p. 44–52.

stakeholders: companies and tax authorities) could filter or adapt the standards for CCCTB use (an endorsement committee is already in place to asses the IAS/IFRS for the commercial accounts). For a more detailed approach to a possible EU Tax Accounting Standards Board I refer to the previous footnote.

8. CONCLUDING REMARKS

The Tax Base in the proposal can be characterised by a profit and loss account approach and the fact that it introduces an independent concept of profit. This concept of profit has been given substance by a few general principles and many concrete rules. There is no fall back system for issues that are not or insufficiently regulated by the Proposal. In this chapter I have demonstrated that there are many such issues, on which tax authorities and companies can (and will) have different points of view. These differences will have to be solved by creating case law. This case law is to be formed by Courts in all 27 Member States, who will all use their own frames of reference to decide the issues that are brought before them. They have no real choice in the matter as the Proposal does not offer such a frame of reference.

I have both theoretical and commercial objections to this set up. From a theoretical point of view the Proposal should have the same meaning and effect in each Member State (which is practically impossible in the current form). From a commercial point of view companies might not be eager to choose CCCTB if that means that they have to put up with uncertainties in their tax liability.

The concept of profit in the Proposal should in my view be given substance by adopting Tax Accounting Standards. IAS/IFRS could be used as a starting point, a board consisting of (for instance) representatives of tax authorities and companies could filter or adapt standards for tax use. This system will not rule out the need for a deciding authority, for instance in cases where the Board cannot reach a decision or if a company feels a standard is a violation of the Proposal, but the occasions to go to Court will be less numerous. Tax Accounting Standards will not solve all problems and it is certainly not an easy solution, but I feel it is preferable to the Proposal in its current form.